REGULATION *for* INNOVATION
- A Comparative Inquiry into a Regulatory Pair of Twins

Purpose of this contribution

Some regulations aim to improve innovation or technological advancement, or at least remove possible obstacles. Competition law, both national and European, is a less known part of the law and is mostly handled by specialised lawyers. The purpose of this contribution is to make the part of competition law that aims to improve innovation more widely known. Two more or less corresponding European regulations will undergo a comparative analysis. An attempt will be made to explain the meaning of these regulations in terms of innovation improvement. An assessment will be made on whether these regulations should both remain in force individually or whether they can be combined into one regulation. The reader will not be expected to have an in-depth knowledge of competition law; an interest in the impact of regulation on the innovative capacity of trade and industry will suffice, or rather, an interest in the theme Innovation and Regulation.

Introduction

In this contribution "innovation" refers to technological improvements in trade and industry that result from innovations in products, processes and organisations. Regulations aimed at stimulating such innovations by providing opportunities, under certain conditions, for undertakings to work together to create innovation, belong to competition law (UK) or antitrust law (US). This legal area is at the intersection of administrative law and business law, thus public and private law. The paradigm *Managerial Law*[1] helps clarify the meaning of the law for the business sector. This paradigm combines (1) the distinction between managerial functions and the structure of these managerial functions and (2) two important objectives of legislation: the normative and the instrumental element. The paradigm helps to position the subject of this paper in the following way.
(Ad 1) Investment in the development of new or improved technology refers at least to the financial managerial function as resources have to be made available that cannot be spent elsewhere. Where improvement refers to product technology it will also involve the production function. For this contribution we have chosen to focus on the way in which competition law stimulates cooperation between undertakings for innovative purposes, which naturally implies the involvement of *strategic* management.

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[1] A. Brack, The Paradigm of Managerial Law, *The Journal of Legal Studies Education*, Vol 15, no 2, (Summer 1997), 237-244; A. Brack, A Managerial Format for a Business Legal Audit, *European Business Law Review*, January/February 2001,Volume 12, Issues 1/2, 34-39; A. Brack, *Bedrijfsrecht op een bedrijfskundige manier*, 4th ed., Groningen/Houten, Wolters-Noordhoff Publishers, 2007

(Ad 2) The *normative* objective of law and legislation is the most obvious: rules that constrict the behaviour of persons and businesses and limit that behaviour within certain frameworks. When applied to managerial functions of undertakings, the normative element of legislation imposes limitations on the freedom of movement of the operational and strategic management.[2] The *instrumental* element of law and legislation is much less obvious.[3] Non-normative, neutral judicial tools, such as agreements, patents and trademarks enable management to establish relationships and protect properties. Legal persons are the building bricks for establishing a group of subsidiary companies subordinate to the Management Board of a shareholding corporation. The normative element of competition law is obvious: strategic management of an undertaking is severely limited in its ability to make arrangements with competitors and the long-term consolidation of undertakings in the form of a merger or takeover is in principle prohibited without prior consent from an Antitrust Authority.

Within the primarily normative system of competition law, there are some legal instruments that aim to facilitate cooperation between undertakings under certain conditions. The goal is to achieve certain societally desirable goals that would have been difficult or impossible to achieve without these forms of cooperation. This is done through the use of the legal vehicle of the *block exemption regulation* (BER). We will provide a short introduction of the main points of competition law in order to explain how cooperation between undertakings is stimulated within a system that is focused on preventing the restriction of competition between undertakings.

Competition law: system and policy

This contribution is not about the private law version of “competition law” that is the domain of topics such as trade practices, commercial publicity, trademarks and advertising. Conversely, our concern here is with the public law version: the influence of the regulatory agency on the degree of competition in markets. The Anglo-American notion of

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[2] Product safety regulations and product liability rules restrict the freedom of project developers. See for example A. Brack, The CE-mark and the new European approach to product law: a system of fundamental legal safety requirements and technical specification standards, *International Journal for Consumer and Product Safety*, Vol. 6. No 2 (1999), pp. 45-59 and A. Brack, A Disadvantageous Dichotomy in Product Safety Law – Some reflections on sense and nonsense of the distinction food-non-food in European Product Safety Law, (under review)

[3] For example: A. Brack and J.F.B. Gieskes, European Legal Developments in Product Liability and Product Safety and the Total Quality Management Approach, *International Journal of Materials & Product Technology*, Vol.5 nr.4 (1990), 311-326. See also A. Brack and J.C. de Ruyter, European Legal Developments in Product Safety and Liability: the Role of Customer Complaint Management as a Defensive Marketing Tool, *International Journal of Research in Marketing*, Vol. 10, nr. 2 (1993), 153-164

antitrust law is a better indicator of the key issue, the prohibition of restrictive practices: competition, that is at least non-cooperation between firms, is the norm. European law, and more specifically European competition law, has a supranational dominance. The Treaty on the European Union articulates (in Article 2) - amongst other objectives - the promotion of economic and social progress, in particular through the creation of an area without internal frontiers. The common rules on competition (Articles 81, 82 and 83 EU Treaty) are an important means to achieve these objectives. They are the foundation of European competition law which, as a system, basically consists of the following three parts
(i) Prohibition of Cartels (Article 81)
(ii) Prohibition of the Abuse of a Dominant Position (Article 82)
(iii) Control of Concentrations (EC Merger Regulation[4]).

This could be denominated as the first level of European competition law. Hereafter, we will see that in the context of this contribution generally two other levels can be distinguished. In light of the main subject of this paper, regulation for innovation, we will focus on the first part (i, above): cartels are anti-competitive agreements. The broadly defined term "collusion" is often used because it covers all the categories of anti-competitive behaviour mentioned in Article 81 namely agreements (written as well as oral), decisions of associations and concerted practices (i.e.: co-ordination of conduct). A difference with USA antitrust law, which is directly focused on maintaining competition, is that the creation of the common market – an area without internal frontiers – is the EU's main objective. It's not so much the restriction on competition, but the restriction on trade between the Member States that should first and foremost be prevented. Fostering good competitive relations is a secondary objective.

Collusions are prohibited as incompatible with the common market if they have as their objective or effect the "prevention, restriction or distortion" of competition within the common market. Article 81 EC Treaty mentions examples of these restrictive practices such as the fixing of prices, the controlling of production volumes, the sharing of markets. Collusions or cartels are automatically void and can be sanctioned with very high fines.
It must be clear that the principal rule, cartels are prohibited, cannot always and absolutely be maintained. This would constitute a severely unsubtle approach. The rule must be applied in an efficient and effective manner. According to the so-called *de minimis*-rule insignificant cartels that do not have a noticeable effect on competition will not be dealt with. Another, more important derogation

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[4] Regulation 139/2004/EC of the Council of 20 January 2004 on the control of concentrations between undertakings, OJ (2004) L24/1

from the principal rule states that a certain level of restriction on competition is allowed, provided that important societal advantages can be achieved, and provided that competition will not be restricted any further than is necessary to achieve these advantages. At this point competition laws meets the overall objective of the Treaty: economic progress. Article 81(3) provides the possibility to exempt certain agreements from the prohibition in article 81(1) on the basis of certain policy considerations. The agreements are then no longer void, but perfectly valid. The Prohibition of Cartels may be declared inapplicable in the case of any agreement (and any decision by an association, and any concerted practice)

"which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit (…)"

It is obvious that this part of European competition law makes it possible to develop and maintain innovation-fostering policies.

Before we turn to rules of the second level – one level below the Articles of the Treaty – it is important to realise that in the past the exception of Article 81(3) could take two alternative forms:
(a) a requested and individually granted exemption from the prohibition rule, and
(b) a so-called block exemption granted beforehand to a certain category of agreements.

The European Commission's practice of applying Article 81 (3) has undergone two important changes as the Community developed over the years. Initially, the Commission only granted individual exemptions. After gaining experience in this mode of application, the Commission started to codify these individual cases in so called block (or "group") exemptions, which state the conditions for the application of Article 81(3). The procedure for companies that wanted to cooperate in one way or another now became as follows: first one would look for the relevant block exemption and assess whether the cartel meets the criteria, so that the wording could be aligned with these criteria in the initial drafting of the agreement. If there was no relevant block exemption or if it proved impossible to adjust the cartel to the available exemption, the second step would follow: the request for an individual exemption. After European corporations and European bureaucracy had operated this way for years, an important change came into effect as of May 1, 2004. It was no coincidence that with the expansion of the EU with a large number of Member States a new regulation came into effect modernising all competition law procedures.[5]

[5] Council Regulation 1/2003/EC of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ 2003 L1/1

By far the most important change concerned the abolishment of the possibility for cooperating undertakings to submit their agreement to the Commission prior to obtaining dispensation. The backlog in the assessment of applications had become too extensive and the Commission wanted a new and more efficient approach. It wanted to spend its human and financial resources on actively investigating the existence of large harmful cartels. The enforcement of the cartel prohibition and the assessment of the exemption possibilities under article 81 (3) has become the responsibility of national competition authorities and the courts of law. Therefore, from now on only *ex post* assessment will take place. Analyses of whether agreements are permissible under European law have become even more important and have become increasingly the responsibility of the cooperating undertakings.

Block Exemption Regulations [6]

Drafting a BER is a creation of legislation on the second level: a detailed and specific elaboration of a rule of the first level. A typical BER in the field of competition law includes the conditions on the basis whereof an agreement will be allowed, that is to say formally that the rule of Article 81(1) (Prohibition of Cartels) is declared inapplicable in the case of agreements that fulfil the terms formulated in the BER. This allows the legislator to determine specific policy objectives for a certain area.

At this point it would be adequate to introduce another basic distinction that is essential to the application of competition law. This is the distinction between horizontal and vertical cartels. The criterion for the distinction is the answer to the question whether or not the undertakings involved are operating at the same level in the production and distribution chain. Suppose that the contracting parties are both in the wholesale trade of certain spirituous beverages. Such an agreement is classified as a *horizontal* cartel. If, on the other hand, the parties are on different levels of the supply chain, their agreement would be classified as a *vertical* one, like the agreement between an importer and the dealers of a certain brand of cars. Companies that become part of a horizontal cartel are restricting competition per definition, because they are competitors.

Vertical agreements, on the other hand, are not necessarily restrictive of competition as the undertakings involved are not each other's direct competitors. The distinction is relevant because in the area of competition policy it is *communis opinio* that a horizontal cartel will most likely constitute a serious infringement of the prohibition to restrict competition[7], whereas vertical cartels are usually judged more leniently. This explains why there are or have been much more BERs

[6] The abbreviation BER is not unusual.

[7] It goes without saying that the same goes for mixed cartels, which is a combination of horizontal and vertical arrangements in one big cartel.

for vertical agreements than for horizontal agreements. For several years now there is even a generally applicable BER for all vertical arrangements. Block exemptions can be laid down in a Council Regulation or in a Commission Regulation and most BERs relate to a certain industry such as agriculture, motor vehicles, insurance and remarkably many branches of the transportation industry: liner shipping, airport services, maritime transport and so on. These are usually mixed or vertical agreements.

With regard to horizontal cartels only a few block exemptions have been established. Two of these relate to improvements of knowledge and it certainly is interesting to research whether it's a coincidence that these block exemptions were created on the same date:
- BER on *specialisation* agreements[8],
- BER on *research & development* agreements[9].
We will conduct a comparative analysis of both regulations and will also refer to the sources of information of the third level: the Guidelines.[10]
Sources of the first and second level, articles of the EC Treaty and Council and Commission Regulations, are formal legal documents that fall under the category of legislation. Guidelines, on the other hand, are informal communications or "notices" published on behalf of the Commission. They are meant to be a more or less official explanation on how to handle legal documents of the second level and are, in that capacity, very interesting. Obviously, the European Court of Justice and the Court of First Instance have to take legislation as an invariable fact but they are in no way bound by the text of guidelines drafted by the Commission. Until now the Commission has published guidelines in the years 2000 on vertical restraints, in 2001 on horizontal cooperation agreements and in 2004 on technology transfer (the licensing of IPR: industrial or intellectual property rights). We will refer to the above mentioned guidelines as the "Horizontal Guidelines".

<u>Preview: comparison of recitals</u>
Instead of an Explanatory Memorandum, on Member State level, that usually accompanies a proposed piece of legislation on its way to Parliament and which, after enactment, is of important value to understand and interpret the provisions of that law, a legislative document of the European Union is preceded by a collection of

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[8] Commission Regulation (EC) No 2658/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of specialisation agreements, OJ 2000 L 304/3
[9] Commission Regulation (EC) No 2659/2000 of 29 November 2000 on the application of Article 81(3) of the Treaty to categories of research and development agreements, OJ 2000 L 304/7
[10] Guidelines on the application of Article 81 EC to horizontal cooperation agreements, OJ 2001 C 3/2

considerations (which regularly begin with "Whereas") the sequence of which is indicated by numbers. These are commonly referred to as "recitals". The entirety of the recitals is essential to comprehend the full scope of such a regulation in all its parts, sections and articles.

At first glance the recitals of both BERs create the presumption that we are dealing with two very similar regulations. Both of the first recitals (1) mention the European Commission's competence to apply the exemption provision of the cartel prohibition to certain cartels ("certain categories of agreements, decisions and concerted practices") which have as their objective *specialisation* (Regulation 2658/2000, hereafter BER-SPEC) or the *research and development* of products or processes (Regulation 2659/2000, hereafter BER-R&D) respectively. The next recital (2) mentions that the foregoing regulation on specialisation (417/85) expires on 31.12.2000. In the case of R&D two specific recitals have been inserted. On the one hand the reference to a special provision in the Treaty (163-2) on research and technological development in undertakings and their collaboration with research centres and universities and on the other hand on the possibility that these forms of collaboration may not qualify as cartels from a competition law point of view. Subsequently, the twin provision of recital (4) mentions that the foregoing regulation on research and development agreements (418/85) also expires on 31.12.2000.

The following five recitals are completely identical.
Recitals (3) and (5) refer to general requirements of a new regulation starting January 1, 2001. Two required key concepts are mentioned:
- simplify both administrative supervision and legislative framework,
- presume *in general* that below a certain level of market power the positive effects of these agreements outweigh any (*sic*) negative effects on competition.

Recitals (4, 5) and (6, 7) define a modern approach, the so-called "economics-based", namely to move away from the legal technique of listing exempted clauses in agreements but to define the categories of agreements which are exempted and the listing of restrictive clauses not to be contained in these agreements. Recitals (6, 7) and (8, 9) contain generalities connected to the chosen modern technique of applying the regulatory or "block" exemption on the prohibition of cartels.

Recitals (8) through (13) in the BER-SPEC are specifically regarding the content of *specialisation* as recitals (10) through (16) in the BER-R&D are specific to the content of *research and development*. We will discuss these substantive considerations later on, when we assess the significance of these regulations in promoting technological innovation.

The remainder of the recitals in both regulations is yet again identical or more or less identical. Recitals (14), (15) and (16) in the one BER

and recitals (17), (18) and (19) in the other BER are totally unisonant and contain standard considerations such as:
- the exemption may not cover restrictions of competition which are not indispensable for the expected benefits,
- certain so-called "hard core"[11] restrictions of competition such as price fixing are not allowed in any circumstances,
- as a final piece of regulatory responsibilities the Commission has the possibility to hit a legal safety break: should an exempted agreement nevertheless, unexpectedly, have severe negative effects on competition, the Commission is empowered to withdraw the benefit of the block exemption for this agreement.
Recitals (17), (18) and (19) in the one BER and recitals (21), (22) and (23) in the other one contain the concluding recitals. Insignificant arguments are given as to why the period of validity of these BERs should be set at ten years: "specialisation agreements can have a bearing on the structure of the participating undertakings"[12] and "research and development agreements are often of a long-term nature". Subsequently, the penultimate recital contains the statement that the regulation(s) "is without prejudice to the application of Article 82 of the Treaty" which is rather obvious, because the article of the Treaty covering the prohibition of cartels is Article 81. This statement is made for the record, because in theory, collaborating undertakings could abuse their collective position of dominance which in itself would constitute an impediment of competition. And finally, the recital that the principle of supremacy of Community law entails that national measures cannot detract from the uniform application of this regulation throughout the common market.

Comparison of articles
These two BERs replace their predecessors which both expired on 31 December 2000. The BER on Specialisation (BERSPEC) and the BER on Research and Development (BER-R&D) have a lot of provisions in common and show more or less the same structure. In fact there is a remarkable resemblance, as we had expected from the comparative overview of the recitals. Both regulations contain 9 articles with headings. These headings are similar for seven out of the nine articles. However, this doesn't necessarily mean that articles with a similar heading also contain similar text. The contents of these articles will be discussed below. First, a short overview will be given.

Article 1, titled "Exemption", stipulates the exemption from the cartel prohibition and distinguishes between three varieties of *specialisation,* and respectively three varieties of *R&D.*
Article 2 ("Definitions") defines the key terminology.

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[11] "Hard core" is well-known jargon within the domain of Competition Law for severe restrictions of competition in any case inexcusable and incompatible with the business enterprise system.
[12] "Undertaking" is euro-legal jargon for business enterprise.

In the BER-SPEC Article 3 has the title "Purchasing and marketing arrangements" and contains an additional exemption for an exclusive purchase and/or supply obligation in the context of a specialisation agreement, or for a joint distribution agreement. In the BER-R&D on the other hand, article 3 ("Conditions for exemption") stipulates additional conditions for the application of the exemption.
In addition, in the BER-SPEC article 4, entitled "Market share threshold", establishes a maximum market share of 20%, whilst in the BER-R&D article 4 ("Market share threshold and duration of exemption") the market share is established at 25%. The latter article also contains special, additional provisions on the validity period of the exemption in specific cases in practice.
The other articles, in line with the first two articles, have similar headings. Article 5: "Agreements not covered by the exemption", lists in both regulations so-called *hard core* agreements that are never allowed in any domain of competition law. Both articles 6 are titled "Application of the market share threshold" and contain a flexible application of the market share criteria. Article 7 in both regulations is entitled "Withdrawal", which refers to the competence of the Commission to withdraw the benefits of the BER. Article 8 ("Transitional period") formulates a rule for the transition from the preceding Regulations No. 417/85 and 418/85 to the current No. 2658/2000 and 2659/2000. And article 9 finally, entitled "Period of validity", states that the current regulations will come into effect on 1 January 2001 and expire on 31 December 2010.

In the light of this comparative study we can qualify the provisions by applying a threefold system with an increasing scale of substantive difference: identical, generic and specific. The qualification <u>*identical*</u> means that the provision in both BERs is textually identical both in content and heading. Two out of the nine articles meet this qualification, namely the last two articles of both regulations. If we apply this criteria more loosely to sections of the articles, then a much larger portion of the regulations qualifies as *identical*. <u>*Generic*</u> means: the text of the article contains a reference to specialisation agreements or research and development agreements, but the text of the comparable articles are mostly identical. Four out of nine articles are considerably generic, but also contain specific elements. An article is qualified as <u>*specific*</u> if the text (or part of the text) is focused on specialisation or R&D. Three out of nine articles have an important or predominantly specific content.

<u>Provisions specific to specialisation</u>
Article 1 BERSPEC declares that the prohibition of cartels in the Treaty (art 81.1) is not applicable (according to art. 81-3) to the following three types of specialisation agreements between two or more undertakings.
- *Unilateral specialisation* agreements: one party agrees to cease or refrain from the production of certain products and purchase them

from a competitor while this competitor agrees to produce and supply those products (party A no longer produces product X and agrees to purchase this product from party B).
- *Reciprocal specialisation* agreements: two or more parties agree to cease or refrain from producing certain different products mutually and purchase these products from the other parties (party A no longer produces product X and agrees to purchase this product from party B while party B no longer produces product Y and agrees to purchase this product from party A).
- *Joint production* agreements: two or more parties agree to produce certain products jointly, that is together, collectively.

The only point of exempting an agreement from the cartel prohibition is of course if otherwise the prohibition would in fact apply to this agreement. Not all cases of specialisation result in the involved undertakings meeting the conditions of the cartel prohibition as stated in Treaty article 81, which is why this BERSPEC-provision states that this must be the case as a systematic, formal condition for exemption. In particular, if parties to the agreement are not competitors – for instance because they are active in different markets, the cartel prohibition will not apply and an exemption will not be necessary. *Apparently the European legislator values unimpeded innovation enhancing activities so highly that exemptions are granted even in cases where this is really unnecessary.* This also goes for provisions contained in specialisation agreements which are directly related to the primary object of the agreement such as intellectual property rights. One can imagine that for instance in a reciprocal specialisation agreement the mutual licensing or "cross-licensing" of these rights is a necessary additional provision.

Article 3 BERSPEC widens the exemption to cases where the parties accept an exclusive purchase and/or supply obligation in the context of the three types of specialisation arrangements. There is also an expansion of the exemption foreseen in the case that parties agree to not to sell the products resulting from their specialisation efforts themselves independently but organise joint distribution instead, or in the case of joint production under certain conditions provide for a third party distributor.

Article 4 BERSPEC contains the important condition for exemption that the combined, that is collective, market share of the participating enterprises including connected companies does not exceed 20% of the relevant market, which is the market for the products that are the result of specialisation.[13]

[13] As we will see later on there is a *generic* provision in both regulations providing for a flexible application of this market share condition.

Article 5 BERSPEC ("Agreements not covered by the exemption") consists of two sections and states in the first one that the exemption is not applicable to certain types of agreements. The second section provides for an exception. It is a given fact in competition law that certain severe impediments on competition can never be allowed, and can thus never be exempted from the prohibition. Cartels that contain these kinds of impediments are called "hard core", although the impediments themselves are also referred to by the same term. In general, as well as in this case, this refers to price fixing, the limitation of output or sales and the allocation of markets or customers. These restrictions on competition are unacceptable because they respectively eliminate price competition, have a price enhancing effect under a similar demand and distort the unrestricted allocation of demand and supply. Surprisingly, in specialisation cartels these restrictions between participants are allowed in certain circumstances. In a unilateral or reciprocal specialisation agreement arrangements can be made on production volume. This is also allowed in regard to a joint production agreement. In the case of joint distribution arrangements are allowed on sales targets and prices charged to third parties.

Article 7 BERSPEC is concerned with the competence of the Commission to withdraw the exemption in certain cases. This article is formulated in very general terms: if the exemption of a certain cartel based on this BER means that unforeseeable effects occur which are incompatible with the conditions of article 81-3 Treaty, the Commission can withdraw the advantages of this exemption from this cartel. This provision follows by stating that this applies particularly in two situations, although very general terms are applied here as well, namely that the agreement does not bring about significant rationalisation results or if consumers do not receive a fair share of the benefits. Subsequently, a somewhat cryptic statement follows, namely that withdrawal of the benefits of the exemption can also occur if the products subject to specialisation are "not subject (…) to effective competition from identical products or products considered by users to be equivalent (…)". If this means that products to be developed in a monopolistic market situation can't benefit from specialisation agreements, then what exactly is the meaning of the market share threshold?[14]

Provisions specific to Research and Development

[14] In this light this provision actually falls within the category of *generic*. But because reference is made to "products which are the subject of the specialisation" and because the similar provision in the BER-R&D is more specific, we will regard this provision as *specific* for pragmatic reasons.

A preliminary remark is that although the BERSPEC does not contain a stand-alone definition of specialisation[15], the central definition is, however, defined in the BER-R&D as “the acquisition of know-how relating to products or processes and the carrying out of theoretical analysis, systematic study or experimentation, including experimental production, technical testing of products or processes, the establishment of the necessary facilities and the obtaining of intellectual property rights for the results”. This is a very nice and all-encompassing description, especially if one realises that know-how is then elaborately defined as “a package of non-patented practical information, resulting from experience and testing, which is secret, substantial and identified: in this context, ‘secret’ means that the know-how is not generally known or easily accessible; ‘substantial’ means that the know-how includes information which is indispensable for the manufacture of the contract products or the application of the contract processes; ‘identified’ means that the know-how is described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality”. This definition clearly does not leave anything to chance, though it is questionable whether it really needs to be so elaborate. A number of R&D related concepts are subsequently defined, such as “contract process”, “contract product” (meaning both the results of the R&D agreement) and “exploitation of the results”.

Article 1 BER-R&D declares that the prohibition of cartels in the Treaty (art 81.1) is not applicable (according to art. 81-3) to the following three types of agreements:
- *joint R&D* of products or processes *and joint exploitation of the results;*
- *joint exploitation of the results* of R&D of products or processes jointly carried out based on a prior agreement between the same parties;
- *joint R&D* of products or processes *excluding* joint exploitation of the results.

Subsequently, similar provisions to the ones in BERSPEC follow, namely the formal reservation that the exemption only applies where the cartel prohibition would be in effect, and that the exemption also applies to agreements that are directly related to the goal and necessity of implementation, i.e. refraining from conducting competitive R&D activities with third parties. Similar provisions have previously been qualified as generic.
Because the BER-R&D applies to joint R&D and/or joint exploitation of results, the following description is useful for a good understanding of this regulation: “research and development, or exploitation of the results, are carried out ‘jointly’ where the work involved is:
(a) carried out by a joint team, organisation or undertaking,
(b) jointly entrusted to a third party, or

[15] Strictly seen this was not necessary as article 1 describes the three varieties of specialisation.

(c) allocated between the parties by way of *specialisation* in research, development, production or distribution" (article 2 section 4 under 11 BER-R&D). It is quite noteworthy that this quoted text connects aspects of research and development with specialisation and thus emphasises the interrelationship of the two BERs.

Article 3 BER-R&D is a substantially different provision than article 3 BERSPEC. The latter could just as easily have been included in article 1, since it contains an extension of the exemption. Article 3 BER-R&D ("Conditions for exemption"), however, states that exemption depends on the following specific conditions:
- for the purpose of further research or exploitation all the agreeing parties, cartel insiders, must have access to the results of the joint R&D[16],
- each party must be free to exploit the results of the joint R&D independently although such exploitation right may be limited to some technical fields of application where the parties in their pre-contractual period were not competing,
- any joint exploitation must relate to results protected by intellectual property rights or constitute know-how, which substantially contributes to technical or economic progress and must be decisive for the manufacture of the contract products or the application of processes.

Finally, in the following condition there is an overlap with the block exemption regulation on specialisation: undertakings that fall under a R&D agreement are responsible for production as a form of specialisation must accept and fill orders from all parties, unless the R&D agreement also provides in joint distribution. This last condition can be understood in a way that, in the case of joint distribution, not all the parties have to be supplied, but merely the joint distributor.

At first glance Article 4 BER-R&D, entitled "Market share threshold and duration of exemption", seems much more complicated than the simple article 4 BERSPEC which just formulates the condition of the market share maximum. However, on closer inspection the text appears to be needlessly complicated. This is caused by the text of the provision that distinguishes between two situations: on the one hand, parties are either competitors or not, and on the other hand it contains a much too complicated formulation of the period of exemption.

If the parties are *not* competitors, the duration of the exemption will be as long as is required for R&D. It is questionable whether this provision is useful, since cooperation will not constitute a restriction on competition if the parties aren't competitors. The duration of joint R&D is also not subject to any time restrictions. If the R&D results are jointly exploited, the exemption will continue for seven years, from the

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[16] Although research institutes, academic bodies or undertakings which supply R&D as a commercial service without normally taking part in the exploitation of the results may confine their use of the results just to further research.

moment that the jointly developed products are first introduced to the common European market. This period appears to be arbitrary and because no other indication can be found, we will assume that the biblical seven fat and seven lean years were the legislator's source of inspiration.
When two or more of the participating undertakings are indeed each other's competitors, the abovementioned period[17] of exemption will only apply when the combined market share of the participating undertakings does not exceed 25% of the relevant products. It is remarkable though that the moment determined to measure the market share is the moment that the parties joined the R&D agreement. Apparently, it does not matter what happens to this market share later on. Finally, the article states that after the initial period of exemption has expired, the exemption will remain in effect *as long as* the combined market share does not exceed 25%. Thus, it is possible that during the initial seven fat years the combined market share exceeds the initially allowed maximum significantly, without any implications from a competition law point of view. It seems much easier and more effective to begin linking the exemption to the maximum allowed market share at the start of the R&D cooperation.

Article 5 BER-R&D contains "Agreements not covered by the exemption" and is more comprehensive than its equivalent in the BERSPEC. The article contains a long list of prohibited agreements, that is to say agreements that cannot fall under the exemption and are therefore likely to be affected by the cartel prohibition of the Treaty. Paragraph 2 contains two exceptions to this rule, so that in these situations the exemption does, yet again, apply.
The "agreements not covered" include, first of all, the previously mentioned "hard core" agreements such as limitation of output or sales and price fixing that are forbidden throughout the domain of competition law. The other agreements not covered are somehow related to R&D arrangements and therefore are qualified as specific in this paper. Most of these agreements contain restrictions that go beyond what is strictly necessary to achieve the goal, namely joint R&D and/or joint exploitation of results. An example is the limitation of the parties' freedom to conduct independent research, or in cooperation with third parties, in an area that is not related to the current agreement. Another example is the protection of the developed knowledge with intellectual property rights for a much longer period than is necessary for the R&D cooperation. Some prohibitions are related to the already mentioned period of seven years: if it benefits successful R&D the number of clients that can be approached may be limited for this period of time, as can the parties limit the areas in which an active sales policy can be conducted.

[17] It is assumed that this period refers to the seven years and not the period of the duration of the R&D, but this is not certain.

The following two agreements do not impede exemption according to paragraph 2;
- production targets may be set in cases where the exploitation of the results includes the joint production of the contract,
- where the exploitation of the results includes the joint distribution of the contract, products sales targets may be set and prices charged to immediate customers may be fixed.

The “Withdrawal” article 7 in the R&D regulation is more extensive than in the other block exemption regulation. One reason for withdrawal of the benefits of the exemption is identical to the one with the cryptic formulation of a quasi monopoly mentioned above. The other reasons are specifically related to R&D, namely
- the existence of this R&D agreement restricts third parties substantially in carrying out R&D because of limited research capacity elsewhere,
- the existence of this R&D agreement restricts third parties substantially in accessing the market for the contract products because of the particular structure of supply,
- the existence of this R&D agreement makes effective competition in R&D on a specific market impossible,
- without any objectively valid reason the parties are not exploiting the results of the joint R&D.

It is remarkable that the apparently different reasons for a limited or absent R&D rest capacity and the further impossibility of R&D competition seem to come down to essentially the same thing. It is crucial for the exemption in competition law that there is a possibility to withdraw the benefits of the exemption if it becomes apparent later on that without an objective reason it is impossible to create results of societal or economic relevance.

<u>Remaining non-specific provisions: generic and identical</u>

Article 2 BERSPEC contains a number of definitions that are relevant for a good understanding, correct interpretation and relevant scope of this regulation. Some are merely formal such as the definition of “agreement”, which repeats part of the text of article 81 Treaty, which describes cartels as “agreement, a decision of an association of undertakings or a concerted practice”. Needless to say that the text ‘agreement means an agreement …’ cannot qualify as a definition. One can also question whether it is necessary to define “product” and “production”, although these terms are given a somewhat broader definition than usual: the provision of a service is included. Other definitions are also not specifically related to innovation improvement, but are more or less customary in the area of competition law, such as the term “connected undertakings”, which, put simply, refers to undertakings that are connected to each other in a group structure. “Participating undertakings” means undertakings party to the agreement and their respective connected undertakings. This

unexpectedly broad definition is of major importance to the market share limit: undertakings connected through a group structure profit a lot less from these block exemptions than independent, or so to say stand-alone undertakings.

A similar term is “competing undertaking” which not just means actual competitor but also covers a potential competitor: “an undertaking that would, on realistic grounds, undertake the necessary additional investments (...) so that it could enter the relevant market (...)”. Many of these definitions are identical because they correspond to normal spoken language or have a more or less standardised meaning within the field of competition law. The definitions that are not specifically related to R&D are *identical* to the definitions of these terms in the other regulation. Therefore, it is on the basis of systematic, regulation-technical design reasons that a larger number of terms are defined in the BER-R&D. In another systematic-technical design the definition article could have been identical or practically identical.

As mentioned before, in both articles 5 (“Agreements not covered by the exemption”) the definitions of ‘hard core’ cartels and ‘hard core’ clauses in agreements are *identical.*

The BERSPEC applies a market share of 20% of the relevant market, whereas the BER-R&D applies a percentage of 25. In both articles 6 (“Application of the market share threshold”) two subjects are regulated. It is indicated how the percentages should be calculated, namely preferably on the basis of market sales value or, where this is not possible, on market share volumes. Furthermore, the market share rule is softened, so as to prevent fluctuations in market shares would result in the block exemption sometimes applying and sometimes not applying. This is a matter of effectiveness and legal certainty. If the increase in the market share is limited to a maximum of 5%, the exemption will remain in effect for a further two years. If the increase exceeds 5%, the exemption will remain in effect for a year. An undertaking cannot receive a suspension for more than two years in total.[18] Except for the percentages, the text of the articles is *identical.*

The two final provisions of both regulations are completely *identical.* Article 8 (“Transitional period”) played an important role when both regulations came into effect on January 1, 2001. Articles 9 (“Period of validity”) declare that the regulation shall expire on December 31, 2010.

<u>Evaluation and recommendations</u>

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[18] In fact a choice has to be made then between either disposing of market share or forming a yet unofficial self-judgment regarding the validity of a direct referral to Article 81-3 Treaty.

The number of articles and parts of articles in the BER specialisation and R&D that are identical or generic exceeds the number of specific provisions. This makes it worthwhile to assess whether both regulations can be brought together into one. Reducing the number of regulations would be an important contribution to lowering the regulatory burden on undertakings. Because the block exemption regulations on specialisation and R&D appeared to be very similar at first glance, this comparative study was carried out. One could consider including the BER on Technology Transfer[19] in a follow-up study, because it aims to achieve the same policy objectives.

The existence of competition law as a system of rules concerning collusions and limitations of competition between undertakings is widely known in circles of business enterprises. Cartels are prohibited. It is therefore remarkable that collaboration between undertakings is allowed "which contributes to improving the production or distribution of goods or to promoting technical or economic progress" (article 81(3) Treaty). Specialisation in production and the acquisition of know-how related to products and processes through research and development are supposed to be such contributions. This sends an important positive signal.
Even though there is very little insight into how much undertakings gain from the advantages of these block exemption regulations, and even though it is not certain which specialisation and R&D agreements would fall under the cartel prohibition without this BER, it is – as such- a positive point that these BERs emphasise that collaboration between undertakings is allowed in the light of innovation and technical and economic progress.

Given that the existence of these regulations is regarded as positive, the question arises in what form they will be continued after December 31, 2010. We can connect to a part of the text in the identical recital (3 BERSPEC and 5 BER-R&D):

> "*A new regulation should meet the two requirements of ensuring effective protection of competition and providing adequate legal security for undertakings. The pursuit of these objectives should take account of the need to simplify administrative supervision and the legislative framework to as great an extent as possible. (…).*"

This text, that almost ten years ago was going to be part of the two Commission Regulations that were assessed in this paper, will no longer have legal force on the date of expiration of these regulations: December 31, 2010. However, the objective laid out in this text is still widely supported. Even more so, reduction of the regulatory burden is

[19] Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements, OJ 27.4.2004, L 123/11

an important goal in the so-called Better Regulation Program.[20] Simplification of these regulations fits perfectly into this program. Integration into one regulation is, as mentioned before, certainly possible. A recommendation in this light is to consider reducing the number of required definitions; one cannot escape the impression that some definitions are very obvious and superficial and could be left out. Implementing another recommendation would even further simplify the consolidation of the exemption on specialisation and R&D agreements into one regulation, and that is harmonising the market share criterion: couldn't the specialisation agreements also be exempt up to a market share of 25%? At this point in time there is no clear-cut reason for these different market share criteria. It seems as though an arbitrary choice was made back then. Another reconsideration regarding the market share criteria might be in order: what is the effect of including so called "connected undertakings"? In order to preserve sufficient competition it seems sensible to work merely with "participating undertakings".

Conclusion

The conclusion is a recommandation. This paper recommends that the expiring BERs on Specialisation and on Research and Development be merged in one new Block Exemption *Regulation on Co-operation for Innovation*. The near occasion of advisable renewal creates an excellent opportunity to contribute to the support of innovation by "Better Regulation" and a reduction of the legislative framework at the same time.

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[20] See for instance the home page of the program's website <http://ec.europa.eu/governance/better_regulation/index_en.htm> and specifically "*A 2nd strategic review of Better Regulation in the European Union*", Commission communication - COM(2008)32 (30 January 2008)

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